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IN THE

Supreme Court of the United States

LEE M. TILL AND AMY M. TILL,

Petitioners,

v.

SCS CREDIT CORPORATION,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF OF THE NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS, THE NATIONAL CONSUMER LAW CENTER, AND THE CONSUMER FEDERATION OF AMERICA AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

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STATEMENT OF INTEREST OF *AMICI CURIAE* [1]

Incorporated in 1992, the National Association of Consumer Bankruptcy Attorneys ("NACBA") is a non-profit organization of more than 1,200 consumer bankruptcy attorneys nationwide. Member attorneys and their law firms represent debtors in an estimated 300,000 bankruptcy cases filed each year. NACBA is the only national association of attorneys organized for the specific purpose of protecting the rights of consumer bankruptcy debtors.

NACBA's corporate purposes include education of the bankruptcy bar and the community at large on the uses and misuses of the consumer bankruptcy process. Additionally, NACBA advocates nationally on issues that cannot adequately be addressed by individual member attorneys. NACBA has filed *amicus curiae* briefs in various appellate courts seeking to protect the rights of consumer bankruptcy debtors, including briefs filed in this Court. *See, e.g., Kawaauhau v. Geiger*, 118 S.Ct. 974 (1998).

The NACBA membership has a vital interest in the outcome of this appeal. NACBA members represent primarily individual low- and moderate-income wage-earners. Many of the bankruptcy cases filed by such wage-earners involve secured debts in chapter 13 bankruptcies. Since the advent of the coerced loan approach, and specifically the presumptive contract rate approach, debtors have been forced to pay much more to secured creditors through their bankruptcies. This harms debtors by raising their chapter 13 plan payments, making their

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[1] All parties to this case have consented to the filing of this brief, and letters indicating consent have been submitted contemporaneously. No counsel for any party authored this brief in whole or in part, and no person or entity other than *amici curiae*, their counsel, or their members made a monetary contribution to the preparation of this brief.

bankruptcies much less feasible, and results in lower payments to other creditors.

The National Consumer Law Center, Inc. (NCLC), is a non-profit corporation established in 1969 to carry out research, education, and litigation regarding significant consumer matters. One of NCLC's primary objectives is to assist attorneys in representing the interests of their low-income and elderly clients in the area of consumer and bankruptcy law. A major focus of NCLC's work has been to increase public awareness of, and to advocate protections against, high-cost loans and other forms of abusive credit extended to low-income consumers. NCLC publishes *The Cost of Credit: Regulation and Legal Challenges* (2d ed. 2000 & Supp. 2003), *Truth in Lending* (4th ed. 1999 & Supp. 2002), and *Consumer Bankruptcy Law and Practice* (6th ed. 2000 & Supp. 2002), among its many other treatises, to assist attorneys whose clients have been victimized by unfair, fraudulent, or deceptive lending practices. In addition, NCLC has directly assisted attorneys in scores of cases brought under federal and state credit protection statutes. The Federal Trade Commission (FTC) designated NCLC as the consumer representative in proceedings that led to the agency's promulgation of its Rules on Preservation of Consumers' Claims and Defenses, 16 C.F.R. Pt. 433 (1998), and Credit Practices, 16 C.F.R. Pt. 444 (1998).

The Consumer Federation of America (CFA) is a non-profit association organized in 1967 to advance the interests of consumers through advocacy and education. CFA's current membership is comprised of almost 300 national, state, and local consumer groups throughout the United States, which, in turn, represent more than 50 million consumers.

CFA has been a leading advocate nationally of balanced consumer bankruptcy laws. In particular, CFA has advocated policies that would make chapter 13 bankruptcy a workable alternative for those who

need it. In addition, CFA has devoted considerable resources to advocacy and educational efforts to protect the interests of consumers in the credit market. CFA has published a series of reports on reckless lending by credit card issuers, abusive credit practices by check cashers, payday lenders and businesses that offer Refund Anticipation Loans, and high fees and deceptive practices among credit counseling agencies. See, e.g. Travis Plunkett and Stephen Brobeck, *Credit Card Issuers Expand Marketing and Available Credit While Consumers Increasingly Say No* (2002), Jean Ann Fox and Edmund Mierzwinski, Consumer Federation of America and U.S. Public Interest Research Group, *Rent-A-Bank Payday Lending – How Banks Help Payday Lenders Evade State Consumer Protections* (2001), and Deanne Loonin and Travis Plunkett, National Consumer Law Center and Consumer Federation of America, *Credit Counseling in Crisis: The Impact on Consumers of Funding Cuts, Higher Fees and Aggressive New Market Entrants* (2003).

The issue before this Court involving the calculation of "present value" is critical to individual debtors who wish to keep their secured collateral and afford their chapter 13 plan payments. *Amici* are particularly concerned that affirmance of the opinion below will substantially undermine the calculated efforts made by Congress to encourage and enable debtors to file chapter 13 bankruptcies.

SUMMARY OF ARGUMENT

The Seventh Circuit's adoption of a presumptive contract rate approach to establish present value under 11 U.S.C. § 1325(a)(5)(B)(ii) is flawed. This approach is inaccurate, overcompensates creditors, and creates undue delay and litigation in the

bankruptcy courts. Further, it is contrary to the plain language and intention of the statute.

The presumptive contract rate approach does not accurately reflect the actual loan rate charged by creditors (even in the original loan). In many situations, the contract rate of return is reduced by a kick-back that a creditor gives to the original dealer or mortgage broker who initiated the loan. Furthermore, the contract rate is established well before the appropriate time to determine present value under the statute. Finally, the contract rate overcompensates creditors for risk. Creditors are already compensated for risk in a bankruptcy by other sections of the Bankruptcy Code, and further, the risk to creditors in chapter 13 bankruptcies is much lower than in the marketplace. These serious deficiencies in the presumptive contract rate approach result in the creditor usually receiving a better rate of return in a bankruptcy than in the marketplace. This clearly is not the intent of the statute.

From the perspective of *amici*, the Seventh Circuit's approach creates a monumental evidentiary hurdle for debtors to clear in order to defeat the presumptive contract rate. This high standard is exacerbated by the unwillingness of creditors to respond to discovery requests about their credit-granting standards and how those standards are applied to determine the actual rate of interest charged to a specific consumer. The creation of such a high evidentiary standard usually results in either debtors acquiescing to the high contract rate, which in turn affects their ability to afford the payments, or protracted litigation in order to force creditors to disgorge the requested information.

The presumptive contract rate approach also is at odds with the plain language and intention of the statute. If Congress had intended that the contract rate be presumed to be the present value rate, such language certainly would have been included in

section 1325(a)(5)(B)(ii). That language is absent for a simple reason. Congress intended not to reinstate a creditor's contract rights in the chapter 13 bankruptcy, but to compensate the secured creditor for the delay in receiving funds, paid over time through the chapter 13 plan. The Seventh Circuit's establishment of a severe presumption in favor of the contract rate is not consistent with the statute. There exist better, more consistent and fairer approaches to determine present value.

ARGUMENT

I. THE PRESUMPTIVE CONTRACT RATE APPROACH TO CALCULATE "PRESENT VALUE" IS FLAWED AND IS INCONSISTENT WITH THE BANKRUPTCY CODE.

a. The presumptive contract rate approach does not accurately reflect the interest rate of return the creditor actually will receive on a new loan of the same duration and risk. Instead, this approach overcompensates creditors.

In many secured loan transactions involving intermediate parties such as car dealers and mortgage brokers, the contract rate does not equal the rate of return that the creditor actually receives from the loan, nor does it reflect the level of risk faced by the creditor. Rather, the actual interest rate that a borrower qualifies for with the creditor is "marked-up" by the dealer or broker originating the loan by adding

several points of interest.[2] This increase is usually split in the form of a lump sum kick-back from the creditor to the dealer or broker. Therefore, the creditor actually receives less than the full contract rate of interest.

By requiring a debtor to presumptively pay the contract rate of interest in bankruptcy, the creditor is overcompensated by being paid more than it would have obtained had it foreclosed and reinvested the proceeds in a similar loan.[3] In the new loan outside of

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[2] The Sixth Circuit opinion in *Coleman v. General Motors Acceptance Corp.*, 296 F.3d 443 (6th Cir. 2002) provides a description of the markup process:

> [T]here are two components to the annual percentage rate ("APR") set in [GMAC's] retail installment sales contracts: the "Buy Rate" and the "Finance Charge Markup". The "Buy Rate" is the portion of the APR that "is the risk- related interest rate required by GMAC for a particular transaction." The "Finance Charge Markup" is "the non-risk charge added to the Buy Rate" by the dealer who must not exceed a limitation set by GMAC's policy. According to the plaintiff, there are incentives in GMAC's retail finance system to "encourage imposition of the subjective non-risk related markup."

Coleman v. General Motors Acceptance Corp., 296 F.3d 443, 445 (6th Cir. 2002), *citing and vacating Coleman v. General Motors Acceptance Corp.*, 196 F.R.D. 315, 318 (M.D. Tenn. 2000).

[3] The court below described the coerced loan approach as follows:

> "Courts taking this view [the coerced loan approach] conceptualize the cramdown provision as forcing creditors to extend a new line of credit to the debtor. Consequently, 'the creditor is entitled to the rate of interest it could have obtained had it foreclosed and reinvested the proceeds in loans of equivalent duration and risk.'" *In re Till*, 301 F.3d 583, 591 (7th Cir. 2002), *citing Koopmans v. Farm Credit Servs. of Mid-America, ACA*, 102 F.3d 874, 875 (7th Cir. 1996).

bankruptcy, interest earned on the reinvested proceeds will be shared with the car dealer or mortgage broker, thereby substantially reducing the amount it would earn in bankruptcy if given the contract rate. This is true even without considering other transactional or relational costs that the creditor would incur in making a new loan with the foreclosure proceeds.

In a hypothetical example, a consumer debtor buys a car from a dealer for $15,000.00 at 21% interest. The financing creditor, however, approves the debtor for a 17% interest rate loan, taking into account the consumer's credit profile and risk to the creditor, based on the creditor's underwriting guidelines. The dealer tells the debtor that the best rate that it can arrange is 21%.[4] The creditor and the dealer then share the additional 4% interest yield. The creditor therefore will receive substantially less than the interest earned at the 21% contract rate. The actual interest rate charged in this example does not reflect the dealer's or creditor's actual transaction costs.

This practice of marking up loans is not limited to the automobile industry. As noted by the Eleventh Circuit in a case involving the payment of "yield spread premiums" to brokers in the home mortgage market,[5] the formula used to mark up interest rates

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[4] In *Coleman v. General Motors Acceptance Corp.*, the consumer plaintiff qualified for an auto loan at the rate of 18.25% under the lender's pricing system, but the dealer "exercised its discretion under the Finance Charge Markup Policy ("markup policy") to increase her interest rate to 20.75%." *Coleman v. General Motors Acceptance Corp.*, 296 F.3d 443, 445 (6th Cir. 2002).

[5] The Department of Housing and Urban Development estimates that mortgage brokers originate more than 60% of the nation's mortgages. *See* RESPA Proposed Rule to Simplify and Improve the Process of Obtaining Mortgages to Reduce Settlement Costs to Consumers, 67 Fed. Reg. 49134 (July 29, 2002), available at: http://hudclips.org/sub_nonhud/cgi/pdf/18960.pdf.

bears no relation to the actual broker services provided in originating the loan:

> The "yield spread premiums" at issue in this case . . . are payments from [the lender] to its mortgage brokers that the written agreement between them contemplates, but does not define. Each business day, [the lender] distributes a rate sheet to its brokers, listing the terms of the loans [the lender] is offering that day. The loans' interest rates are set with reference to a "par rate." If the broker originates a loan at a below-par rate, it gets no compensation from [the lender]. On the other hand, originating a loan at an above-par rate garners the broker a yield spread premium, whose amount is determined by a formula that includes the amount of the loan and the difference between the loan rate and the par rate. The formula does not take into account the amount of work the broker actually performed in originating the loan or how much the borrower paid in fees for the broker's services.

Culpepper v. Irwin Mortgage Corp., 253 F.3d 1324, 1325 (11th Cir. 2001), *cert. denied*, 122 S.Ct. 930 (2002).[6]

See also *United Carolina Bank v. Hall*, 993 F.2d 1126, 1131 (4th Cir. 1993)(court refused to presumptively apply the contract or "gross" interest rate as an estimate of present value due to fact that

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[6] While most mortgages in a chapter 13 bankruptcy are paid pursuant to 11 U.S.C. § 1322(b)(2), many are paid pursuant to section 1325(a)(5). When a mortgage loan matures prior to the end of the bankruptcy, the loan may be paid under section 1325(a)(5). 11 U.S.C. § 1322(c)(2).

creditors often buy loan contracts from mobile home dealers at a discount).

The common practice of marking up interest rates on consumer loans severely undermines the assumption in the lower court's opinion that the contract rate is an accurate approximation of the interest rate that the creditor would receive on a new loan of the same duration and risk. The marked-up interest rate does not reflect risk because the creditor has already approved the loan, taking risk into consideration, at the lower "par" rate.

This disparity between the final marked-up interest rate charged to the borrower and the level of risk to the creditor is even more dramatic in the subprime consumer loan market. Recent research conducted of the subprime mortgage market suggests that often there is little or no justification based on risk for the large differential in rates charged by many subprime lenders.[7] Another report suggests that subprime mortgage borrowers are often charged rates that are not commensurate with their credit profiles, and that approximately 10% to 35% of subprime borrowers could qualify for lower cost, conventional "prime" financing.[8]

Since risk is not considered in the marked-up interest rate, a creditor's interest rate for similarly

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[7] *See, e.g.*, Howard Lax, Michael Manti, Paul Raca, and Peter Zorn, "Subprime Lending: An Investigation of Economic Efficiency," (Feb. 25, 2000) (Freddie Mac study that compared the interest rates on subprime loans rated A-minus by the lenders originating these loans, with the rates on prime loans purchased by Freddie Mac, which Freddie Mac then rated A-minus using its underwriting model; Freddie Mac found that, on average, the subprime loans bore interest rates that were 2.15% [215 basis points] higher than its loans; the study could find no justification for such a large discrepancy).

[8] *See*, Freddie Mac, "Automated Underwriting: Making Mortgage Lending Simpler and Fairer for America's Families", Chapter 5, September, 1996, available at: http://www.freddiemac.com/corporate/reports/moseley/chap5.htm.

situated debtors may vary greatly depending upon the ability of the dealer or broker to "upsell" the loan to individual consumers. This is particularly true in the subprime market for lenders such as the respondent in this case. *In re Till*, 301 F.3d at 593 (*dissenting opinion*)("By its own account, the interest rate that SCS charges its customers for sub-prime, used car loans is whatever the market will bear.").

The use of a presumptive contract rate as an approximation of what creditors would charge similarly situated debtors under a coerced loan approach may have a racially discriminatory effect based on evidence suggesting that the mark-up practice in the automobile industry has resulted in a discriminatory impact on racial minorities.[9] In one recent lawsuit challenging the practice, an automotive finance company has agreed to institute a credit pre-approval program offering "no markup" rates to black and Hispanic buyers who have never declared bankruptcy or had cars repossessed.[10]

The practice of interest rate mark-ups has drawn attention from state governments. On July 14, 2003, the State of California enacted legislation to curb the mark-up of interest rates. Cal. Civil Code § 2984.5. This statute requires lenders to maintain records concerning the loan and creditworthiness of the consumer for up to seven years, to enable the California Attorney General to investigate possible

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[9] *See* "Final Report on Racial Impact of NMAC's Finance Charge Markup Policy" issued in *Cason et al vs. Nissan Motor Acceptance Corporation*, Case No. 3-98-0223 (C.D. Tenn.) available at: http://www.nclc.org/initiatives/cocounseling/content/Final Report.pdf.

[10] The settlement provides that the company will make 675,000 such offers over five years. *See* Associated Press, *Nissan Proposes Discrimination Settlement*, N.Y. Times, February 20, 2003, available at: http://www.nclc.org/initiatives/cocounseling/content/NYTimes_article.pdf.

violations of the law.[11] The legislative history of Cal. Civil Code § 2984.5 reflects the concerns of the Committee of the Judiciary of the California State Assembly in the reported interest rate abuses by car dealers and lenders. [12]

In sum, the contract rate that many consumers pay is not based on their risk factors but instead reflects their vulnerability to predatory lending tactics or the racially discriminatory impact of mark-up practices. As such, the presumptive contract rate is an inaccurate and faulty approach to determine present value. It does not recognize that the marked-up portion of the interest rate is received by the dealer or broker, not the lender. When used broadly for all secured loans, as required by the Seventh Circuit, it overcompensates many secured creditors by paying them more interest than they would receive outside of a bankruptcy on a new loan of the same duration and risk.[13]

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[11] Danny Hakim, *Davis Signs Fair Lending Bill*, N.Y. Times, July 16, 2003, available at: http://www.carconsumers.com/cars_in_the_news-govD.html.

[12] "This bill is intended as a first step in addressing abuses by some car dealers when they arrange loans for buyers. **As has been widely reported in the press, and is being litigated in numerous lawsuits, many buyers who finance through the dealership are charged an interest rate several percentage points higher than what is approved by the lender, even while being told that they are getting the best rate available. The additional markup amount is then reportedly split between the lender and the dealer.** Several lawsuits allege that these markups are made in a discriminatory manner, disproportionately affecting African-American and Latino buyers." (Emphasis added.) Assembly Judiciary Committee Analysis, SB 508, 2003-2004 Regular Session, (June 10, 2003), available at: http://www.leginfo.ca.gov/pub/bill/sen/sb_0501-0550/sb_508_cfa_ 20030610_163357_asm_comm.html.

[13] The presumptive contract rate is also inaccurate based on the timing of the valuation of "present value." The Seventh Circuit's intent in mandating the use of the presumptive contract rate method is to estimate the coerced loan rate of interest at the

b. The presumptive contract rate approach overcompensates creditors for risk.

The presumptive contract rate approach overcompensates creditors for risk.[14] Outside of bankruptcy, creditors appropriately charge a higher rate of interest to offset risk. This risk premium is included in the contract rate of interest. In a chapter 13 bankruptcy, however, other statutory provisions protect creditors from risk and actually lower the creditor's risk.

First, if the creditor is undersecured or thinly secured, it has a right to adequate protection. Section 361 is the primary section of the bankruptcy code ensuring creditors of adequate protection. This section defines adequate protection as including periodic cash payments to the extent that the automatic stay against repossession results in a

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time the bankruptcy plan is confirmed. *In re Till*, 301 F.3d 583, 592 (7th Cir. 2002). The problem with the Seventh Circuit's approach is that a contract is normally consummated well before a chapter 13 plan is filed or confirmed. The interest rate established in the contract is based on the factors present as of the time of the consummation of the contract. When a bankruptcy is filed, the factors that affect interest rates may well have changed. This is demonstrated by the fluctuation of Treasury Bill rates from 1998-2000. See "Economic Trends," Federal Reserve Bank of Cleveland, p. 8 (Nov. 2002) at http://www.clev.frb.org/research/Et2002/1102/Trends.pdf and "What makes Treasury bill rates rise and fall? What effect does the economy have on T-Bill rates?" Federal Reserve Bank of San Francisco (Dec. 2000) at http://www.frbsf.org/education/activities/drecon/2000/0012.html.

[14] The rationale supporting the presumptive contract rate approach states that a creditor "is entitled to the rate of interest it could have obtained had it foreclosed and reinvested the proceeds in loans of equivalent duration and risk." *In re Till*, 301 F.3d 583, 591 (7th Cir. 2002). The Respondent argues that it should be entitled to contract rate to compensate it for the risk of non-payment on its loan. SCS's Brief and Supplemental Appendix to the Seventh Circuit, pp. 29-30.

decrease in a secured creditor's interest in the property. Thus, the creditor has the right to demand that payments it is to receive under the plan will at least keep up with the property's depreciation. Similarly, the concept of adequate protection clearly encompasses the right to have the property insured.

Second, if the debtors make sporadic payments or no payments in their chapter 13 plan, the creditor can receive relief from the automatic stay pursuant to 11 U.S.C. § 362(d). At that point, the creditor is entitled to immediate return of its collateral, the case typically is dismissed, and the creditor has the right to revert to state law remedies. In other words, the creditor will be able to collect not only its contract interest rate but also, under almost every form consumer credit contract, all of the attorney fees and costs that it incurred during the bankruptcy. The presumption of the contract rate to protect present value is simply not relevant if the plan fails; therefore, the possibility of plan failure is not a valid basis for requiring the contract rate.[15]

Third, there are other protections in place in a chapter 13 to protect a secured creditor and reduce its risk. All debtors must submit all or such portion of their income to the supervision and control of the trustee as is necessary to execute the plan. 11 U.S.C. § 1322(a)(1). Debtors usually are ordered by the bankruptcy court to have their chapter 13 plan payments deducted directly from their wages

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[15] In this regard, there is far less risk to the creditor than in a chapter 11 case. In a chapter 11 case, the debtor receives a discharge immediately upon confirmation. 11 U.S.C. § 1141(d). If the debtor does not pay pursuant to the confirmed plan, the creditor must often enforce its rights in state court, but the debtor still retains the discharge of the unsecured portion of the claim. In a chapter 13, the debtor must complete his plan payments in order to obtain a full chapter 13 discharge. 11 U.S.C. § 1328(a). A chapter 13 bankruptcy thus protects creditors to a greater extent than does a chapter 11 by requiring completion of the plan before the debtor receives a discharge.

pursuant to 11 U.S.C. § 1325(c), increasing the likelihood that the plan will complete and the creditors will be paid.[16] The chapter 13 trustee monitors, collects and disburses funds to the creditor, and also enforces the creditor's rights to plan payments, if necessary, through motions to dismiss for nonpayment pursuant to 11 U.S.C. §§ 1302 and 1307 or motions to increase payments pursuant to 11 U.S.C. § 1329(a).[17] The creditor also is entitled to file motions to dismiss or to convert the case to a chapter 7 under 11 U.S.C. § 1307.

Fourth, this Court compensated creditors for risk when the Court adopted replacement value as the standard for determining the value of collateral under section 506(b). *Associates Commercial Corp. v. Rash*, 520 U.S. 953, 117 S.Ct. 1879 (1997). The Court held that debtors are to pay the replacement value of collateral, as opposed to a foreclosure value of collateral, based in part on the goal of compensating creditors for risk.

> If a debtor keeps the property and continues to use it, the creditor obtains at once neither the property nor its value and is exposed to double risks: The debtor may again default and the property may deteriorate from extended use. Adjustments in the interest rate

[16] *In re Torres*, 191 B.R. 735, 737 (Bankr. N.D. Ill. 1996)("...since one of the requirements for confirmation is a showing that 'the debtor will be able to make all payments under the plan.' 11 U.S.C. § 1325(a)(5). A preconfirmation wage deduction order establishes the debtor's ability to make plan payments, despite prior budgeting difficulties. It may well make the difference between success and failure of a chapter 13 case.")

[17] The trustee saves the creditor a substantial amount of time and expense by essentially operating as the creditor's unpaid collection agent. The creditor does not pay for these tasks, which instead are paid for by the debtor, who pays the trustee's fees through the bankruptcy plan. 11 U.S.C. §§ 330(c) and 1326(b)(2).

> and secured creditor demands for more "adequate protection," 11 U.S.C. § 361, do not fully offset these risks.

520 U.S. at 962-963, 117 S.Ct. at 1885.

The Seventh Circuit's presumptive contract rate approach overcompensates creditors by double-counting for risk, considering risk in determining both the valuation of the property and the interest rate. The following hypothetical illustrates overpayment to the creditor under the presumptive contract approach after *Rash*. A consumer buys a vehicle for $15,000.00 at 21% interest. At the time of the bankruptcy, the replacement value of the car, pursuant to the Court's decision in *Rash*, is $10,000.00. If the creditor were able to repossess the vehicle, it would be sold at its wholesale/foreclosure value for $5,000.00.[18] Pursuant to the underlying coerced loan theory of *Till*, the creditor would then loan this sum at 21% over 36 months, and it would receive $6,782.00 ($1,782.00 in interest).[19]

However under the Seventh Circuit's presumptive contract rate approach, the creditor is entitled to be paid $10,000.00 at 21%. At the end of a three year plan, the creditor would be paid $13,564.00 ($3,564.00 in interest), far in excess of what it could have earned had the collateral been repossessed and sold under state law.

[18] *In re Weathington*, 254 B.R. 895, 900 (B.A.P. 6th Cir. 2000) ("...the commercial reality is that creditors that repossess vehicles most often sell them wholesale at auctions."); *In re Zell*, 284 B.R. 569, 573 (Bankr. D. Md. 2002)("The value Chevy Chase Bank would have received if it had repossessed the vehicle, is the wholesale value of the car.")

[19] "Consequently, 'the creditor is entitled to the rate of interest it could have obtained had it foreclosed and reinvested the proceeds in loans of equivalent duration and risk.'" *In re Till*, 301 F.3d 583, 591 (7th Cir. 2002), *citing Koopmans v. Farm Credit Servs. of Mid-America, ACA*, 102 F.3d 874, 875 (7th Cir. 1996).

Contrast this result with the goal of section 1322(a)(5)(B)(ii), as stated by the Seventh Circuit in *Till* as **"seek[ing] to put the secured creditor in an economic position equivalent to the one it would have occupied had it received the allowed secured amount immediately, thus terminating the relationship between the creditor and the debtor."** (emphasis added) *In re Till*, 301 F.3d 583, 591 (7th Cir. 2002).

By requiring the debtor to pay the contract rate of interest on the replacement value of the collateral, **the Seventh Circuit gives the creditor twice the amount of interest it would have received had the debtor surrendered the property ($3,564.00 compared to $1,782.00).** The presumptive contract rate approach overcompensates creditors by double-counting for risk, considering risk in determining both the valuation of the property and the interest rate. This is clearly not the intent of section 1325(a)(5)(B)(ii).

The *Till* court missed the point of section 1325(a)(5)(b). That section is designed to compensate the creditor more for the time value of money and less for risk. The primary rights and safeguards protecting secured creditors from risk spring from numerous other sections of the Bankruptcy Code, including 11 U.S.C. §§ 361, 362, 506, 1302, 1307, 1322, 1325(c) and 1329, not the present value test of section 1325(a)(5).[20] That Congress established these separate protections against risk militates against the

[20] While it is true that this Court dealt with this issue of adequate protection and not the issue of plan interest rates in *Timbers*, in that case, the Court also recognized the Congressional intent to protect unsecured creditors by reducing, at least to some degree, secured creditors' rights to interest. *United Savings Association v. Timbers of Inwood Forest*, 484 U.S. 365, 373, 108 S.Ct. 626, 631 (1988), (unfair to pay undersecured creditor interest from estate's unencumbered assets before unsecured creditors had recovered any principal) *citing Vanston Bondholders Protective Committee v. Green*, 329 U.S. 156, 164, 166, 67 S.Ct. 237 (1946).

argument that creditors should be presumptively paid the contract rate of interest to protect them against risk.

c. The presumptive contract rate approach creates delay and inefficiency in the administration of a chapter 13 bankruptcy.

The presumptive contract rate approach imposes a monumental burden of proof upon debtors that causes delay and inefficiency. Under this approach, debtors are required to demonstrate that the creditor would charge an interest rate different than the contract rate when lending money to a similarly situated debtor.

The problem arises from the fact that the creditor itself is typically the only source of information to rebut this presumption. For example, many creditors create rate sheets that set forth their rates of return (kickbacks) to the initial dealers or mortgage brokers after mark-up. Also, creditors have their own individual formulas for calculating the initial rate of interest on a loan. There is no other source than that specific creditor for this information. Unfortunately, debtors, who are paying all their disposable income into the plan (as required by 11 U.S.C. § 1325(b)(1)), rarely have additional funds to hire an expert and conduct an independent investigation.[21]

Following the Seventh Circuit's ruling in *Till*, debtors must exercise their rights for formal discovery under Bankruptcy Rules 9014 and 7026-7037

[21] "Given that the most undeniable element in this entire equation is that most chapter 13 debtors will not possess the resources necessary to finance a full-scale litigation of the presumption issue, it seems apparent that the imposition of the contract rate will simply be a foregone conclusion in the vast majority of chapter 13 cases." *In re Richard*, 241 B.R. 403, 409 (Bankr. E.D. Tex. 1999).

(depositions, interrogatories, requests for production, etc.) to obtain this information. A secured creditor faced with requests for information normally objects and refuses to produce the information. Attorneys for consumers seeking information on the establishment of the contract interest rate then must file and argue motions to compel discovery pursuant to Bankruptcy Rule 7037. In response, the creditor then usually files a motion for protective order pursuant to Bankruptcy Rule 7026. This has occurred in bankruptcy cases in which the debtor has attempted to obtain this information[22] and in class action lawsuits against Nissan and General Motors Acceptance Corporation.[23]

In some instances, the creditors may have legitimate concerns about releasing information concerning trade secrets, confidential research and development, or commercial information concerning their credit granting standards. The resolution of these concerns may entail lengthy hearings and complex findings and orders of the court to compel discovery while protecting the creditor.

An important goal in the management of a chapter 13 bankruptcy is the minimization of litigation and administrative costs.[24] The presumptive contract

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[22] Debtors have filed motions to compel discovery answers to challenge the presumptive contract rate in *In re Hartman*, Case No. 02-34092 (Bankr. S.D. Ill. 2002)(Document #50 Motion to Compel, #53 Objection to Motion to Compel), *In re Foxworth*, 03-30208 (Bankr. S.D. Ill. 2003)(Document #51 Motion to Compel, #56 Objection to Motion to Compel). *See also* Cal. Civil Code § 2984.5, which was enacted to make discovery of this information easier.

[23] *Cason et al vs. Nissan Motor Acceptance Corporation*, Case No. 3-98-0223 (C.D. Tenn.), *Coleman et al vs. General Motors Acceptance Corporation*, Case No. 3-98-0211 (C.D. Tenn.).

[24] "Since chapter 13 cases adjust the debts of the individual wage earner, such cases tend to be rather high in volume and low in absolute value, making a reduction of the litigation and transactions costs of chapter 13 cases an important prudential consideration." *General Motors Acceptance Corp. v. Jones*, 999 F.2d 63, 70 (3rd Cir. 1993). See also *Matter of Smithwick*, 121 F.3d 211, 214 (5th Cir. 1997).

rate approach's heavy discovery requirement, coupled with the reluctance of creditors to cooperate, conflicts with this goal. The presumptive contract rate approach thus delays the chapter 13 plan confirmation process and the ease of administration and payment of claims. Surely this is not the intent of section 1325(a)(5)(B)(ii).

d. The presumptive contract rate approach is contrary to the plain language of section 1325(a)(5)(B)(ii).

The plain language of section 1325(a)(5)(B)(ii), contrasted with other provisions of the Bankruptcy Code, indicates that Congress intentionally omitted the requirement that debtors presumptively pay the contract rate of interest to compensate creditors for their present value interest. Under the maxim *expressio unius est exclusio alterius*, "the expression of one thing is the exclusion of another," an express statutory requirement here, contrasted with statutory silence there, shows an intent to confine the requirement to the specified instance. In *Field v. Mans*, 516 U.S. 59, 116 S.Ct. 437 (1995) this Court wrote:

> The argument relies on the apparent negative pregnant, under the rule of construction that an express statutory requirement here, contrasted with statutory silence there, shows an intent to confine the requirement to the specified instance. See *Gozlon-Peretz v. United States*, 498 U.S. 395, 404, 111 S.Ct. 840, 846-847, 112 L.Ed.2d 919 (1991) ("'[W]here Congress includes particular language in one section of a

> statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion.'") (quoting *Russello v. United States*, 464 U.S. 16, 23, 104 S.Ct. 296, 300, 78 L.Ed.2d 17 (1983)).

516 U.S. at 67, 116 S.Ct. at 442.

In section 1325(a)(5)(B)(ii), Congress did not include the term "contract" or similar terms evidencing payment pursuant to the contract or agreement. Congress, however, did include these terms clearly in other sections of the Bankruptcy Code. See 11 U.S.C. § 1322(e) (debtor curing a mortgage arrearage claim must pay interest on that claim if provided for in the agreement) and 11 U.S.C § 506(b) (creditor entitled to payment of contract interest when the value of the collateral exceeds the lien on the collateral). The fact that Congress placed specific requirements to pay contract interest in other sections of the Bankruptcy Code, but was silent on contract interest in section 1325(a)(5)(B)(ii), indicates that Congress did not intend to require debtors to pay contract interest when paying present value.

This interpretation is consistent with the Court's recent case of *F.C.C. v. NextWave Personal Communications Inc.*, 123 S.Ct. 832, 842 (2003). This Court held that Congress means what it says. In contrast, the Third, Fifth and Seventh Circuits have ignored the plain language of the Code, circumvented Congressional intent and legislated the presumptive contract rate approach.

e. A chapter 13 plan is not a loan transaction, and the present value calculation under section 1325(a)(5)(B)(ii) should not be presumptively based on the debtors' contract rate. Other, more appropriate methods can be used to compensate a secured creditor for present value.

The presumptive contract rate approach, and the underlying coerced loan theory, posit that the appropriate present value rate to be paid to a secured creditor best approximates "the rate it would voluntarily accept for a loan of similar character." *General Motors Acceptance Corp. v. Jones*, 999 F.2d 63, 67 (3rd Cir. 1993).

The fundamental flaw in this approach is that a chapter 13 bankruptcy case is not a loan transaction voluntarily bargained for by a creditor, but rather a multiparty collective proceeding established by Congress to rehabilitate individual debtors and to ensure fair treatment of all creditors. The legislative history of chapter 13 and the 1978 Bankruptcy Code is replete with references to these twin basic bankruptcy objectives -- a fresh start for the consumer debtor and equity among creditors.[25]

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[25] "The premises of the bill with respect to a consumer bankruptcy are that use of the bankruptcy law should be a last resort; that if it is used, debtors should attempt repayment under chapter 13 ...; and, finally, whether the debtor uses chapter 7 ... or chapter 13 ..., bankruptcy relief should be effective, and should provide the debtor with a fresh start... The purpose of chapter 13 is to enable an individual, under court supervision and protection, [to] develop and perform under a plan for the repayment of his debts over an extended period. In some cases, the plan will call for full repayment. In others, it may offer creditors a percentage of their claims in full settlement ... This protection relieves the debtor from indirect and direct pressures from creditors, and enables him to support himself and his dependents while repaying his creditors

Nothing in the history of chapter 13 suggests a purpose of fully protecting the bargain of the secured creditor at the cost of meeting those objectives.

The provisions of section 1325(a)(5)(B) are intended to protect the property rights of secured creditors. A secured creditor may oppose confirmation of a chapter 13 plan unless the plan protects its property interest, i.e., its lien on the debtor's property. The Code provides two alternative methods of protection: surrender of the property to the creditor (after which any remaining deficiency claim of the creditor is treated no differently than other unsecured claims) or the "cramdown" of section 1325(a)(5)(B). Under the latter, the secured creditor is permitted to retain its lien after confirmation of the debtors' plan, giving it protection against other creditors and the possibility of the plan's failure, and receive payment on the full replacement value (as opposed to its foreclosure value) on its secured claim.[26]

The purpose of section 1325(a)(5)(B)(ii), normally met by the payment of interest, is to ensure that the secured creditor's property rights are not prejudiced by any delay in payment due to the chapter 13 plan. This purpose can be seen clearly from the alternative available under the Code. The alternative,

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at the same time. The benefit to the debtor of developing a plan of repayment under chapter 13, rather than opting for liquidation under chapter 7, is that it permits the debtor to protect his assets. In a liquidation case, the debtor must surrender his nonexempt assets for liquidation ... Under chapter 13, the debtor may retain his property by agreeing to repay his creditors. Chapter 13 also protects a debtor's credit standing far better than a straight bankruptcy ... The benefit to creditors is self-evident: their losses will be significantly less than if their debtors opt for straight bankruptcy." H.Rep. No. 95-595, pp. 116-118 (1977), U.S. Code Cong. & Admin.News 1978 pp. 5787, 6076, 6078.

[26] "Our recognition that the replacement-value standard, not the foreclosure-value standard, governs in cram down cases..." *Associates Commercial Corp. v. Rash*, 520 U.S. 953, 965, 117 S.Ct. 1879, 1886 (1997).

absent some other agreement by the creditor, is for the creditor to receive the collateral.

The *Till* court, and others adopting similar holdings, fail to recognize that the Code's purpose is simply to protect the creditor's property right -- the right to get the same amount as if it had received its collateral. Instead, those courts attempt to reinstate the secured creditor's contract rights, i.e., the benefit of its bargain and the debtor's concomitant obligations, by treating the plan as a "forced loan" with an interest rate presumptively the same as in the original contract. This contract interest rate does more than compensate for the delay in payment. It requires the debtor to pay a rate that includes transaction costs, profit, and a premium for risk; in other words, all of the benefits of the bargain that the creditor received in the original contract. This is not the intent or the focus of section 1325(a)(5)(B)(ii).

Further, adopting the presumptive contract rate approach will reward the most exploitive and overreaching creditors and is unfair to other creditors. Two secured creditors with similar property interests may receive radically different treatment. For example, under the presumptive contract rate approach, a debtor in a chapter 13 plan could be required to pay 8% interest to the holder of a third mortgage and 20% interest to the holder of a second mortgage on the same property, even if both mortgages were fully secured and there was substantial equity.

Unsecured creditors are prejudiced as well. Unsecured creditors usually receive whatever is left from the debtor's disposable income after secured creditors are paid. If that pot of disposable income is depleted because a secured creditor is receiving compensation for profits, costs and risk, the unsecured creditors receive less on their principal debt, despite taking risks that were greater than those of the secured creditor. Both secured and unsecured

creditors have contract rights, transaction costs, and intend to make profits. Since the only valid distinction between secured and unsecured creditors in the Code is that the former has a property interest, the interest rate should not go beyond that which is absolutely necessary to protect that interest.

Amici firmly believe that this Court should adopt a method to fairly protect the creditor while not overcompensating the creditor in the process. This method should be based on the time value of money, taking into account current market rates of interest to approximate the creditor's actual losses due solely to delay because of the bankruptcy. It should not compensate the creditor for the profit it would have received outside the bankruptcy. *In re Valenti*, 105 F.3d 55 (2nd Cir. 1997), *In re Dominick*, 244 B.R. 51 (Bankr. N.D. N.Y. 2000), *In re St. Cloud*, 209 B.R. 801 (Bankr. E.D. Mass. 1997).

It should not overcompensate the creditor for risk factors as well. Instead, this Court should allow the bankruptcy judge some discretion to determine if the interest rate to be allowed should be increased by a small, additional risk premium.

This is the approach used in *In re Valenti*, 105 F.3d 55 (2nd Cir. 1997). *Valenti* seeks to compensate the creditor for its actual loss of use of money while not overcompensating for risk. *Valenti* has the virtue of referring to a well defined, national standard and making slight additional adjustments for risk that fairly balance the interest of all creditors and debtors in the bankruptcy process. It streamlines the process by allowing a hearing only on the small risk premium, and only after the parties are unable to agree.

Amici also firmly believe that this Court should not adopt the "forced loan" approach of *Till* and its predecessors.

> These courts have treated the chapter 13 deferral of payments like a new loan transaction, which provides the holder of the allowed secured claim with not only the cost of the funds it would lend but also the costs of a new loan transaction, which would not be incurred, and the profit that would be earned in that transaction. Neither of these latter two amounts would be received if the collateral were surrendered; the lender would have to incur new transaction costs to earn an additional profit. To include them in the present value discount rate gives the holder of an allowed secured claim more than the equivalent of immediate payment of that claim in full.

Collier on Bankruptcy, ¶ 1325.06[3][b] pp. 1325-36 (15th Ed. 2002).

Finally and most importantly, the Court should not legislate an impossible presumption as to the interest rate to be applied where no such presumption is contained in the Code. The Court should give bankruptcy judges discretion as to the factual determination of the interest rate to be applied.[27] This is consistent with the Court's review of section 1325(a)(5) in *Associates Commercial Corp. v. Rash*, 520 U.S. 953, 117 S.Ct. 1879 (1997). In *Rash*, the Court stated that it is necessary to give bankruptcy judges discretion as to the issue of value, noting that:

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[27] It is important to note that in locations of the country where a non-presumptive contract rate approach has been applied, it is the experience of NACBA and its attorneys that it is uncommon for debtors and creditors to constantly litigate issues of present value interest. In most areas, counsel for debtors and creditors routinely meet and agree on a simple mathematical formula to apply in most cases. This method allows flexibility for changes based on fluctuations in the economy, and for regional differences in credit and collateral.

> Our recognition that the replacement-value standard, not the foreclosure-value standard, governs in cram down cases leaves to bankruptcy courts, as triers of fact, identification of the best way of ascertaining replacement value on the basis of the evidence presented.

520 U.S. at 965, 117 S.Ct. at 1886.

In *Till*, the Seventh Circuit effectively removed any discretion from the bankruptcy courts with its adoption of the presumptive contract rate approach.

CONCLUSION

For all the foregoing reasons, this Court should reverse the decision below of the Seventh Circuit.

Respectfully submitted,

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